

## HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

### EXEMPT ORGANIZATIONS

**Announcement 97-53, page 22.**

A list is given of organizations now classified as private foundations.

### EMPLOYMENT TAX

**Page 4.**

**Railroad retirement; rate determination; quarterly.**

The Railroad Retirement Board has determined that the rate of tax imposed by Code section 3221 shall be 35 cents for the quarter beginning April 1, 1997.

**Announcement 97-52, page 22.**

**Extension of test of employment tax early referral procedures for appeals.** This announcement describes the method by which a taxpayer requests early referral of one or more unagreed employment tax issues from the District to Appeals.

### ADMINISTRATIVE

**Notice 97-31, page 5.**

**Qualified long-term care.** Interim guidance is provided

on the definition of a "chronically ill individual" for purposes of the definitions of "qualified long-term care services" and a "qualified long-term care insurance contract" under Code section 213(d).

**Notice 97-32, page 8.**

This notice sets forth the interim rules regarding the rate of interest to be used by insurance companies to compute under Code sections 807(c)(3) or 807(d)(2) reserves for modified guaranteed contracts as defined in Code section 817A, and the determination of policy interest under Code section 812 with regard to these contracts.

**Rev. Proc. 97-27, page 10.**

**Changes in accounting periods and methods of accounting.** General procedures are provided under Code section 446(e) and section 1.446-1(e) of the Income Tax Regulations for obtaining the Commissioner's consent to change a method of accounting for federal income tax purposes.

## Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the

quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

## Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

# Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semi-annually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

## **Part I.—1986 Code.**

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

## **Part II.—Treaties and Tax Legislation.**

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

## **Part III.—Administrative, Procedural, and Miscellaneous.**

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

## **Part IV.—Items of General Interest.**

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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# Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

## Section 101.—Certain Death Benefits

*26 CFR 1.101-1: Exclusion from gross income of proceeds of life insurance contracts payable by reason of death.*

Interim guidance is provided relating to the definition of a “chronically ill individual” for purposes of the treatment of certain accelerated death benefits. See Notice 97-31, page 5.

## Section 104.—Compensation for Injuries or Sickness

*26 CFR 1.104-1: Compensation for injuries or sickness.*

Interim guidance is provided relating to the definition of a “chronically ill individual” for purposes of the definition of a “qualified long-term care insurance contract” under section 7702B. See Notice 97-31, page 5.

## Section 105.—Amounts Received Under Accident and Health Plans

*26 CFR 1.105-2: Amounts expended for medical care.*

Interim guidance is provided relating to the definition of a “chronically ill individual” for purposes of the definition of a “qualified long-term care insurance contract” under section 7702B. See Notice 97-31, page 5.

## Section 213.—Medical, Dental, Etc., Expenses

*26 CFR 1.213-1: Medical, dental, etc., expenses.*

Interim guidance is provided relating to the definition of a “chronically ill individual” for purposes of the definitions of “qualified long-term care services” and a “qualified long-term care insurance contract” under section 213(d). See Notice 97-31, page 5.

## Section 446.—General Rule for Methods of Accounting

*26 CFR 1.446-1: General rule for methods of accounting.*

General procedures are provided under section 1.446-1(e) for obtaining the Commissioner’s consent to change a method of accounting. See Rev. Proc. 97-27, page 10.

## Section 481.—Adjustments Required by Changes in Method of Accounting

*26 CFR 1.481-1: Adjustments in general.*

General procedures are provided under section 1.446-1(e) for obtaining the Commissioner’s con-

sent to change a method of accounting. See Rev. Proc. 97-27, page 10.

*26 CFR 1.481-4: Adjustments taken into account with consent.*

General procedures are provided under section 1.446-1(e) for obtaining the Commissioner’s consent to change a method of accounting. See Rev. Proc. 97-27, page 10.

## Section 807.—Rules for Certain Reserves

The notice sets forth the interim rules regarding the rate of interest to be used by insurance companies to compute under sections 807(c)(3) or 807(d)(2) reserves for modified guaranteed contracts as defined in section 817A, and the determination of policy interest under section 812 with regard to these contracts.

## Section 812.—Definition of Company’s Share and Policyholders’ Share

The notice sets forth the interim rules regarding the rate of interest to be used by insurance companies to compute under sections 807(c)(3) or 807(d)(2) reserves for modified guaranteed contracts as defined in section 817A, and the determination of policy interest under section 812 with regard to these contracts.

## Section 817A.—Special Rules for Modified Guaranteed Contracts

The notice sets forth the interim rules regarding the rate of interest to be used by insurance companies to compute under sections 807(c)(3) or 807(d)(2) reserves for modified guaranteed contracts as defined in section 817A, and the determination of policy interest under section 812 with regard to these contracts.

## Section 3221.—Rate of Tax

### Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in Section 3221(c) of the Railroad Retirement Tax Act (16 U.S.C., Section 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such Section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning April 1, 1997, shall be at the rate of 35 cents.

In accordance with directions in Section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning April 1, 1997, 31.5 percent of the taxes collected under Sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 68.5 percent of the taxes collected under such Sections 3211(b) and 3221(c) plus 100 percent of the taxes collected under Section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated February 25, 1997.

By Authority of the Board.

Beatrice Ezerski,  
Secretary to the Board.

(Filed by the Office of the Federal Register on March 5, 1997, 8:45 a.m., and published in the issue of the Federal Register for March 6, 1997, 62 F.R. 10297)

## Section 4980C.—Requirements for Issuers of Qualified Long-term Care Insurance Contracts

Interim guidance is provided relating to the definition of a “chronically ill individual” for purposes of the term “qualified long-term care insurance contract” and to certain issues relating to consumer protection, rules for adjustments to nonforfeiture benefits, and grandfather rules for certain pre-1997 insurance contracts. See Notice 97-31, page 5.

## Section 7121.—Closing Agreements

*26 CFR 301.7121-1: Closing agreements.*

What is the method by which a taxpayer requests early referral of one or more unagreed employment tax issues from the District to Appeals? See Announcement 97-52, page 22.

## Section 7702B.—Treatment of Qualified Long-Term Care Insurance

Interim guidance is provided relating to the definition of a “chronically ill individual” and to certain issues relating to consumer protection, rules for adjustments to nonforfeiture benefits, and grandfather rules for certain pre-1997 insurance contracts. See Notice 97-31, page 5.

## Part III. Administrative, Procedural, and Miscellaneous

### Long-Term Care Services and Insurance

#### Notice 97-31

This notice provides interim guidance relating to qualified long-term care services and qualified long-term care insurance contracts under §§ 213, 7702B, and 4980C of the Internal Revenue Code. It is effective pending the publication of proposed regulations or other guidance.

#### SUMMARY

The notice includes interim guidance concerning the definition of a “chronically ill individual,” including safe-harbor definitions of the terms “substantial assistance,” “hands-on assistance,” “standby assistance,” “severe cognitive impairment,” and “substantial supervision.” Under the long-term care provisions added to the Internal Revenue Code in 1996, certain payments received on account of a chronically ill individual from a qualified long-term care insurance contract are excluded from income. In addition, certain expenditures incurred for qualified long-term care services required by a chronically ill individual are deductible as medical care expenses.

The notice also includes an interim safe harbor that allows key provisions in qualified long-term care insurance contracts to be interpreted by an insurance company using the same standards that the company used before 1997 to determine whether an individual is unable to perform activities of daily living or is cognitively impaired. In addition, the notice provides interim guidance on the scope of the statutory grandfather provisions that apply to individual and group long-term care insurance contracts issued before 1997.

The safe harbors are designed to provide standards for taxpayers to use in interpreting the new long-term care provisions and to provide interim guidance to facilitate operation of the insurance market without the need for interim amendment of contracts.

The guidance takes into account comments and information provided by State insurance regulators (including the National Association of Insurance Commissioners), insurance companies offering long-term care insurance, consumer representatives, groups representing individuals with chronic disabilities, the De-

partment of Health and Human Services, health professionals expert in the care and rehabilitation of individuals with chronic illnesses, and others. The notice addresses certain issues identified as those for which interim guidance would be most helpful. The Internal Revenue Service and Treasury Department are continuing to consider these and other issues and welcome further comments.

#### STATUTORY CHANGES

Sections 7702B and 4980C, added by §§ 321 and 326 of the Health Insurance Portability and Accountability Act of 1996 (Pub. L. 104-191, 110 Stat. 1936, 2054 and 110 Stat. at 2065)(HIPAA), establish requirements for qualified long-term care insurance contracts and issuers of those contracts. Section 7702B(b)(1)(A) requires a qualified long-term care insurance contract to provide insurance protection only for qualified long-term care services. Generally, § 7702B applies to contracts issued after December 31, 1996, and § 4980C applies to actions taken after December 31, 1996. *See* HIPAA §§ 321(f)(1) and 327.

Section 7702B(c)(1) defines “qualified long-term care services” as necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal care services that are required by a chronically ill individual, and provided pursuant to a plan of care prescribed by a licensed health care practitioner.

Section 7702B(c)(2)(A) defines a “chronically ill individual” as any individual who has been certified by a licensed health care practitioner as —

- (i) being unable to perform without substantial assistance from another individual at least 2 out of 6 activities of daily living listed in § 7702B(c)(2)(B) (ADLs) for a period of at least 90 days due to a loss of functional capacity (the ADL Trigger);
- (ii) having a level of disability similar to the level of disability described in the ADL Trigger as determined under regulations prescribed by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services (the Similar Level Trigger); or
- (iii) requiring substantial supervision to protect the individual from threats to health and safety due to severe

cognitive impairment (the Cognitive Impairment Trigger).

The 6 ADLs listed in § 7702B(c)(2)(B) are eating, toileting, transferring, bathing, dressing, and continence. Section 7702B(c)(2)(B) further provides that a contract is not a qualified long-term care insurance contract unless it takes into account at least 5 of these 6 activities in determining whether an individual is a chronically ill individual.

In addition, § 322 of HIPAA amended § 213 of the Code. For taxpayers who itemize deductions, § 213 generally allows a deduction for expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his or her spouse, and dependents, to the extent that the expenses exceed 7.5 percent of the taxpayer’s adjusted gross income. As amended by HIPAA, § 213(d) provides that the term “medical care” includes (1) eligible premiums paid for any qualified long-term care insurance contract (as defined in § 7702B(b)) and (2) amounts paid for qualified long-term care services (as defined in § 7702B(c)).

#### INTERIM GUIDANCE

##### I. CHRONICALLY ILL INDIVIDUAL

This section of the notice provides interim guidance including safe harbors relating to the determination of whether an individual is a “chronically ill individual” under § 7702B(c)(2). Taxpayers (including uninsured individuals, insurance companies, employers, policyholders, and certificate holders) may rely on this interim guidance to determine whether an individual is a chronically ill individual under the ADL Trigger or the Cognitive Impairment Trigger for purposes of the definitions of “qualified long-term care services” in § 7702B(c) and “medical care” in § 213(d).

*ADL Trigger.* For purposes of the ADL Trigger, taxpayers may rely on all or any of the following safe-harbor definitions —

(1) “Substantial assistance” means hands-on assistance and standby assistance.

(2) “Hands-on assistance” means the physical assistance of another person without which the individual would be unable to perform the ADL.

(3) “Standby assistance” means the presence of another person within arm’s reach of the individual that is necessary

to prevent, by physical intervention, injury to the individual while the individual is performing the ADL (such as being ready to catch the individual if the individual falls while getting into or out of the bathtub or shower as part of bathing, or being ready to remove food from the individual's throat if the individual chokes while eating).

An individual is a chronically ill individual under the ADL Trigger only if a licensed health care practitioner has certified that the individual is unable to perform (without substantial assistance from another individual) at least 2 ADLs for a period of at least 90 days due to a loss of functional capacity. This 90-day requirement does not establish a waiting period before which benefits may be paid or before which services may constitute qualified long-term care services.

**Cognitive Impairment Trigger.** For purposes of the Cognitive Impairment Trigger, taxpayers may rely on either or both of the following safe-harbor definitions—

(1) “Severe cognitive impairment” means a loss or deterioration in intellectual capacity that is (a) comparable to (and includes) Alzheimer’s disease and similar forms of irreversible dementia, and (b) measured by clinical evidence and standardized tests that reliably measure impairment in the individual’s (i) short-term or long-term memory, (ii) orientation as to people, places, or time, and (iii) deductive or abstract reasoning.

(2) “Substantial supervision” means continual supervision (which may include cuing by verbal prompting, gestures, or other demonstrations) by another person that is necessary to protect the severely cognitively impaired individual from threats to his or her health or safety (such as may result from wandering).

Under the Cognitive Impairment Trigger, unlike the ADL Trigger, a qualified long-term care insurance contract is not required to take any ADL into account for purposes of determining whether an individual is a chronically ill individual.

**Safe-Harbor for Continuation of Pre-1997 Insurance Standards.** This safe harbor applies to post-1996 long-term care insurance contracts (including any pre-1997 contracts not grandfathered under § 321(f)(2) and the grandfather rules in this notice for certain pre-1997 insurance contracts) issued by an insurance company with outstanding pre-1997 long-term care insurance contracts that base eligibility for payments upon the inability to perform any of the ADLs

(eating, toileting, transferring, bathing, dressing, and continence) or cognitive impairment. Insurance companies, policyholders, and certificate holders may rely on this safe harbor (as well as the safe-harbor definitions above for the ADL and Cognitive Impairment Triggers) to determine whether an individual is a chronically ill individual under both or either the ADL Trigger and the Cognitive Impairment Trigger for purposes of the definition of a “qualified long-term care insurance contract,” whether or not the post-1996 contracts generally incorporate the provisions of § 7702B(c)(2). In order to rely on any of these safe harbors for federal tax purposes, contracts are not required to incorporate or refer to the safe harbors.

In applying the ADL Trigger to its post-1996 contracts, an insurance company is permitted to use the same standards that it uses to determine whether an individual is unable to perform an ADL for purposes of eligibility for benefit payments under its pre-1997 contracts (“pre-1997 ADL standards”). If the insurance company makes determinations regarding an individual’s inability to perform an ADL under a post-1996 contract using its pre-1997 ADL standards, the contract will be deemed to satisfy the requirement under the ADL Trigger that an individual is unable to perform (without substantial assistance from another person) that ADL due to a loss of functional capacity. For example, if an insurance company has outstanding pre-1997 long-term care insurance contracts that provide for benefit payments if the insured is unable to perform at least 2 ADLs (whether or not the contracts refer to substantial assistance), the company may interpret “substantial assistance” for purposes of the ADL Trigger as requiring the same assistance as the company requires under its pre-1997 contracts.

In applying the Cognitive Impairment Trigger to its post-1996 contracts, an insurance company is permitted to use the same standards that it uses to determine whether an individual qualifies for benefits due to cognitive impairment under its pre-1997 contracts (“pre-1997 cognitive impairment standards”). If the insurance company makes determinations regarding an individual’s cognitive impairment under a post-1996 contract using its pre-1997 cognitive impairment standards, the contract will be deemed to satisfy the requirement under the Cognitive Impairment Trigger that an

individual requires substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairment.

This safe harbor for continuation of pre-1997 insurance standards applies only for purposes of determining whether an individual (1) is unable to perform (without substantial assistance from another person) an ADL due to a loss of functional capacity or (2) requires substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairment. This safe harbor does not apply for purposes of the other statutory requirements of § 7702B(c)(2), such as (1) the requirement that an individual’s loss of functional capacity apply to at least 2 of 5 or 6 ADLs, (2) the requirement for a certification by a licensed health care practitioner, and (3) the 90-day requirement. These statutory requirements must be satisfied in order for the individual to be a “chronically ill individual” under the ADL or Cognitive Impairment Trigger, whether or not similar requirements are imposed under the insurance company’s pre-1997 contracts.

## II. QUALIFIED LONG-TERM CARE INSURANCE

This section of the notice addresses certain issues relating to the consumer protection provisions of §§ 7702B(b), 7702B(g), and 4980C, rules for adjustments to nonforfeiture benefits under § 7702B(g)(4), and the grandfather rules for certain pre-1997 insurance contracts. Taxpayers (including insurance companies, employers, policyholders, and certificate holders) may rely on this interim guidance for purposes of the definition of “qualified long-term care insurance contract” in § 7702B(b) and the requirements of § 4980C.

**Consumer Protections Applicable to Long-Term Care Insurance.** Under §§ 7702B(b)(1)(F), 7702B(g), and 4980C, qualified long-term care insurance contracts and issuers of those contracts are required to satisfy certain requirements of the Long-Term Care Insurance Model Act (Model Act) and Long-Term Care Insurance Model Regulation (Model Regulation) promulgated by the National Association of Insurance Commissioners (NAIC), as adopted as of January 1993. The requirements for qualified long-term care insurance contracts under §§ 7702B(b)(1)(F) and 7702B(g) relate to guaranteed renewal or noncancellability, prohibitions on

limitations and exclusions, extension of benefits, continuation or conversion of coverage, discontinuance and replacement of policies, unintentional lapse, disclosure, prohibitions against post-claims underwriting, minimum standards, inflation protection, prohibitions against preexisting conditions and probationary periods, and prior hospitalization. The requirements for qualified long-term care insurance contracts under § 4980C relate to application forms and replacement coverage, reporting requirements, filing requirements for marketing, standards for marketing, appropriateness of recommended purchase, standard format outline of coverage, delivery of a shopper's guide, right to return, outline of coverage, certificates under group plans, policy summary, monthly reports on accelerated death benefits, and incontestability period.

Sections 7702B and 4980C reference NAIC model provisions that specify exact language (including punctuation), captions, format, and content that must be included in long-term care insurance contracts, applications, outlines of coverage, policy summaries, and notices. See, e.g., §§ 10, 13, and 24 of the Model Regulation.

In the case of a State that has adopted all or any portion of the Model Act or Model Regulation, compliance with the applicable requirement of State law is considered compliance with the parallel Model Act or Model Regulation requirement specified in § 7702B(g) or § 4980C, and failure to comply with that requirement of State law is considered failure to comply with the parallel Model Act or Model Regulation requirement in § 7702B(g) or § 4980C. For example, if a particular State has adopted Section 6C of the Model Act (relating to preexisting conditions), then, for a contract that is subject to that State's insurance laws, compliance with that State law is considered compliance with § 7702B(g)(2)(A)(ii)(I) and failure to comply with that State law is considered failure to comply with § 7702B(g)(2)(A)(ii)(I). In accordance with § 4980C(f), in the case of a State that imposes a requirement that is more stringent than the analogous requirement imposed by § 7702B(g) or § 4980C, compliance with the applicable requirement of State law is considered compliance with the parallel Model Act or Model Regulation requirement in § 7702B(g) or § 4980C.

If a State has not adopted a provision of the Model Act or Model Regulation

that is specified in § 7702B(g) or § 4980C (and has not adopted a requirement that is more stringent than the requirement imposed by that provision), the language, caption, format, and content requirements imposed by the Model Act or Model Regulation provision with respect to contracts, applications, outlines of coverage, policy summaries, and notices will be considered satisfied for a contract subject to the law of that State if the language, captions, format, and content are substantially identical in all material respects to those required under that Model Act or Model Regulation provision.

*Adjustments to Nonforfeiture Benefits Under Insurance Contracts.* Section 7702B(g)(4)(B)(ii) provides that the amount of a nonforfeiture benefit available in the event of a default in premium payments may be subsequently adjusted only as necessary to reflect changes in claims, persistency, and interest that have been taken into account in a change in the premium rates for contracts issued on the same contract form if the contract form has been approved by the Secretary of the Treasury. Solely for the purpose of making such adjustments, approval by the State insurance commissioner or other applicable State authority will be treated as approval by the Secretary of the Treasury.

*Grandfather Rules for Certain Pre-1997 Insurance Contracts.* Section 321(f)(2) of HIPAA provides that a contract issued before January 1, 1997, is treated as a qualified long-term care insurance contract if the contract met the "long-term care insurance requirements of the State" in which the contract was situated at the time it was issued. For this purpose, the "long-term care insurance requirements of the State" means the State laws (including statutory and administrative law) that are intended to regulate insurance coverage that constitutes "long-term care insurance" (as defined in § 4 of the Long-Term Care Insurance Model Act as adopted by the NAIC in December, 1995), regardless of the terminology used by the State in describing the insurance coverage.

For purposes of applying the grandfather rule of § 321(f)(2) to a contract other than a group contract, the issue date of a contract is generally the date assigned to the contract by the insurance company, but in no event earlier than the date the application is signed. How-

ever, if the period between the date of application and the date on which the contract is actually placed in force is substantially longer than under the insurance company's usual business practice, then the issue date is the date the contract is placed in force.

For purposes of applying the grandfather rule of § 321(f)(2) to a group contract, the issue date of the contract is the date the group contract was issued. Thus, insurance coverage under certificates evidencing the addition, on or after January 1, 1997, of individuals to the coverage available under a grandfathered group contract is accorded the same grandfather treatment under § 321(f)(2) as the preexisting coverage under the grandfathered group contract.

A policyholder's right to return a long-term care insurance contract within a "free-look" period following delivery (with a refund of any premiums that have been paid) is not taken into account in determining the issue date of the contract.

For purposes of applying the grandfather rule of § 321(f)(2), any material change in a contract will be considered the issuance of a new contract. This includes any change in the terms of the contract altering the amount or timing of any item payable by the policyholder (or certificate holder), the insured, or the insurance company. For example, for purposes of § 321(f)(2), any change in the terms of a contract altering the amount or timing of benefits (including nonforfeiture benefits) or premiums constitutes a material change that will be considered the issuance of a new contract. A substitution of the insured under an individual contract, or a change (other than an immaterial change) in the eligibility for membership in the group covered by a group contract, also constitutes a material change that will be considered the issuance of a new contract. However, the unilateral exercise of an option or right granted to a policyholder under the contract as in effect on December 31, 1996, will not constitute a material change. For this purpose, a unilateral exercise includes only a change that becomes effective without any consent or other non-ministerial action by the issuer of the contract. A contract issued in an exchange after December 31, 1996, for an existing contract is considered a contract issued after that date.

## COMMENTS REQUESTED

The Internal Revenue Service and Treasury Department invite comments concerning the application of new §§ 7702B and 4980C, the amendments made to § 213, and other federal income tax provisions relating to long-term care as enacted under HIPAA §§ 321 through 326, including the standards and definitions in this notice. Comments are particularly requested on: (1) whether the relief provided for insurance contracts complying with the interim guidance provided in this notice needs to be extended beyond the effective date of more definitive guidance; and (2) the types of disability that should be included in any regulations that may be prescribed under the Similar Level Trigger. Comments should be submitted by August 4, 1997. Written comments should be sent to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Attn: CC:CORP:T:R, Room 5228, Washington, DC 20044. Alternatively, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (Notice 97-31), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Finally, taxpayers may submit comments electronically via the Internal Revenue Service INTERNET site at: [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html). All submitted comments will be available for public inspection and copying.

## FURTHER INFORMATION

For further information, contact Ms. A. Kathie Jacob Kiss at (202) 622-4920 regarding section I of this notice and Ms. Katherine A. Hossofsky at (202) 622-3970 regarding section II of this notice (not toll-free calls).

## PROCEDURAL INFORMATION

This document serves as an “administrative pronouncement” as that term is defined in § 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or a revenue procedure.

(Also Part I, sections 807, 812, 817A)

## Modified Guaranteed Contracts

### Notice 97-32

**SUMMARY:** This notice provides interim rules with regard to the interest

rate to be used in the determinations under §§ 807(c)(3), 807(d)(2)(B), and 812 for a “modified guaranteed contract,” as defined in § 817A(d). It also describes the manner in which § 811(d) is to be applied to these contracts. Section 817A was added by § 1612 of the Small Business Job Protection Act of 1996, Pub. L. 104-188, 110 Stat. 1755. Section 817A is effective for taxable years beginning after December 31, 1995. See Small Business Job Protection Act § 1612(c)(1). This notice is effective pending the publication of further guidance.

**BACKGROUND:** Life insurance companies issue modified guaranteed annuity and life insurance contracts. A modified guaranteed contract temporarily guarantees a higher return than the permanently guaranteed crediting rate, in exchange for shifting additional investment risk to the policyholder in the form of a market value adjustment. The temporary guarantee may be a fixed rate or a rate based on bond or equity yields, such as a percentage of an increase in the S&P 500 index. During the temporary guarantee period, the amount paid to the policyholder upon surrender is increased or decreased by the market value adjustment, which is determined by a formula in the modified guaranteed contract. The market value adjustment generally is based on a published bond index. Modified guaranteed contracts can be issued out of a life insurance company's general account or segregated account. Section 817A provides special tax treatment for certain modified guaranteed contracts issued out of a segregated account.

For this purpose, the term “modified guaranteed contract” (“MGC”) is defined as an annuity, life insurance, or pension plan contract (other than a variable contract described in § 817) under which all or part of the amounts received under the contract are allocated to a segregated account. Assets in this segregated account must be valued from time to time with reference to market values, and reserves must be valued at market for annual statement purposes. Further, an MGC must provide either for a net surrender value or for a policyholder's fund (as defined in § 807(e)(1)). If only a portion of a contract is not described in § 817, such portion is treated as a separate contract for purposes of applying § 817A.

The tax reserves for an MGC are computed under either § 807(c)(3) or

§ 807(d). Section 807(c)(3) provides that reserves for obligations under insurance and annuity contracts not involving life, accident, or health contingencies are computed using an appropriate rate of interest. The appropriate rate of interest is the highest (as of the time the obligation first did not involve life, accident, or health contingencies) of the following rates: (1) the “applicable Federal interest rate” (as defined in § 807(d)(2)(B)(i)); (2) the “prevailing State assumed interest rate” (as defined in § 807(d)(2)(B)(ii)); or (3) the rate of interest assumed by the insurance company to determine the contract's guaranteed benefit. Section 807(c) also provides that the reserves computed under § 807(c)(3) are never less than the net surrender value of the contract.<sup>1</sup>

For an MGC that gives rise to life insurance reserves, as defined in § 816(b), reserves are computed under § 807(d). Under § 807(d)(1), the life insurance reserves for a contract cannot exceed the statutory reserves (as defined in § 809(b)(4)(B)) for the contract. Subject to that cap, a contract's life insurance reserves equal the greater of: (1) the contract's net surrender value; or (2) the contract's Federally prescribed reserve determined under § 807(d)(2).

Section 807(d)(2) provides that the Federally prescribed reserves for a contract are determined using: (1) the tax reserve method applicable to the contract; (2) the greater of the applicable Federal interest rate or the prevailing State assumed interest rate in effect on the date of the issuance of the contract; and (3) the prevailing commissioners' standard tables for mortality and morbidity. In the case of a life insurance contract covered by the Commissioners' Reserve Valuation Method (“CRVM”) or an annuity contract covered by the Commissioners' Annuities Reserve Valuation Method (“CARVM”), § 807(d)(3) provides that the tax reserve method applicable to a contract is the CRVM or CARVM prescribed by the National Association of Insurance Commissioners (“NAIC”), which is in effect on the date of the issuance of the contract.

Section 811(d) imposes an additional reserve computation restriction for contracts that guarantee beyond the end of

<sup>1</sup>For contracts other than MGCs, § 807(e)(1) provides that net surrender value is determined taking into account any penalty or charge which would be imposed upon surrender but ignoring any market value adjustment. The net surrender values of MGCs, however, take into account market value adjustments. § 817A(a).



the taxable year payment or crediting of amounts in the nature of interest in excess of the greater of the prevailing state assumed interest rate or the applicable Federal interest rate. In those circumstances, § 811(d) requires that the contract's future guaranteed benefits be determined as though the interest in excess of the greater of the prevailing state assumed interest rate or the applicable Federal rate were guaranteed only to the end of the taxable year.

Section 812 prorates the dividends received deduction and the exclusion for tax exempt interest between a life insurance company and its policyholders to prevent the company from receiving a double tax benefit for amounts added to reserves. *See also* §§ 805(a)(4), 807(a) and 807(b). The proration is based on the company's share of "net investment income" (as defined in § 812(c)) for the taxable year. The company's share of net investment income equals the excess, if any, of the net investment income over the sum of the "policy interest" (as defined in § 812(b)(2)) and "gross investment income's proportionate share of policyholder dividends" (as defined in § 812(b)(3)) for the taxable year. Policy interest includes "required interest" (at the greater of the prevailing State assumed rate or the applicable Federal interest rate) on reserves under § 807(c) (other than § 807(c)(2)). *See* § 812(b)(2)(A). If neither the prevailing State assumed rate nor the applicable Federal interest rate is used, another appropriate rate is used to calculate required interest. Thus, for a contract described in § 807(c)(3), if the rate of interest assumed by an insurance company in determining the contract's guaranteed benefit exceeds the applicable Federal interest rate and the State assumed rate, required interest is computed using the assumed interest rate.

Under § 817A(e)(2), the Service is authorized to determine annually with regard to MGCs the interest rates applicable under §§ 807(c)(3), 807(d)(2)(B) and 812. The Service is authorized to exercise this authority by issuing a periodic announcement of the appropriate market interest rates or formula for determining such rates. H.R. Conf. Rept. No. 737, 104th Cong. 2d Sess. 313 (1996). Section 817A(e) also authorizes the Service to modify or waive the application of § 811(d) (relating to interest guaranteed beyond the end of the taxable year), and to prescribe other

regulations that are necessary or appropriate to carry out the purposes of § 817A.

The legislative history of § 817A indicates that an appropriate interest rate is a current market rate. H.R. Conf. Rep. No. 737, at 313. The interest rate may be determined, for example, using either a rate that is appropriate for the obligations under the contract to which the reserve relates or the yield on the assets underlying the MGCs. *Id.*

**INTERIM RULES FOR MGCs:** Pending the publication of further guidance, an insurance company is required to determine under §§ 807(c)(3) or 807(d)(2) the reserves for a MGC using, with regard to the contract's temporary guarantee period, an annual interest rate equal to the greater of—

(a) the interest rate assumed by the insurance company to determine future guaranteed benefits under the applicable tax reserve method for the contract or, for reserves computed under § 807(c)(3), the interest rate assumed by the company to determine the contract's guaranteed benefit; or

(b) the Moody's Corporate Bond Yield Average-Monthly Average Corporates ("Moody's rate") as published by Moody's Investors Service, Inc., or any successor thereto, for the month that includes the last day of the taxable year, multiplied by:

(i) 1.1 if the MGC provides for a market value adjustment or a guaranteed return based in whole or in part on the performance of stocks, other equity instruments or equity-based derivatives, including but not limited to a contract which guarantees a return based on the S&P 500 index; and

(ii) 1.0 for all other MGCs.

With respect to an MGC's temporary guarantee period, section 811(d) shall be applied by substituting the rate of interest applicable to the contract's temporary guarantee period under this notice for the applicable Federal interest rate and the prevailing State assumed interest rate. During the temporary guarantee period, the interest rate to be used to determine required interest under § 812(b)(2)(A) is the rate that applies with regard to that period for purposes of §§ 807(c)(3) or 807(d)(2)(B).

For periods outside the temporary guarantee period, §§ 807(c)(3), 807(d)(2), 811(d) and 812(b)(2)(A) continue to apply without modification.

## EXAMPLE 1

IC, a life insurance company as defined in § 816, issued an MGC on July 1, 1996. The MGC is an annuity contract that gives rise to life insurance reserves, as defined in § 816(b). IC is a calendar year taxpayer. The MGC guarantees that interest will be credited at 8% per year for the first 5 contract years and 4% per year thereafter. During the 5 year temporary guarantee period, the MGC provides for a market value adjustment based on changes in a published bond index and not on the performance of stocks, other equity instruments or equity based derivatives. The Moody's rate for December 1996 is 7.5%. The applicable Federal interest rate and the prevailing State assumed interest rate for 1996 are 6.63% and 5.75%, respectively.

To determine under § 807(d)(2) the end of year 1996 reserves for the MGC, IC must use a discount interest rate of 8% (the interest rate assumed by the insurance company to determine future guaranteed benefits during the 5 year temporary guarantee period) with regard to the unexpired portion of the temporary guarantee period. The discount rate applicable to periods outside the 5 year temporary guarantee period is 6.63%. The interest rate to be used in computing required interest under § 812(b)(2)-(A) for 1996 is 8%.

## EXAMPLE 2

The facts are the same as in Example 1, except that the MGC guarantees that interest will be credited at 7% per year for the first 5 contract years. To determine under § 807(d)(2) the end of year 1996 reserves for the MGC, IC must use a discount interest rate of 7.5% (Moody's rate multiplied by 1.0) with regard to the unexpired portion of the 5 year temporary guarantee period. The discount rate applicable to periods outside the 5 year temporary guarantee period is 6.63%. The interest rate to be used in computing required interest under § 812(b)(2)(A) for 1996 is 7.5% (Moody's rate multiplied by 1.0).

**COMMENTS REQUESTED:** The Internal Revenue Service invites comments concerning the application of new § 817A and the application of this notice to various types of MGCs, including equity indexed annuities and life insurance contracts. Specifically, comments are requested regarding whether different interest rates should apply to equity indexed contracts based upon the differ-

ent participation rates, guarantees, market value adjustments, or other pertinent factors under the contracts. Written comments should be sent to Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (Notice 97-32), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Finally, taxpayers may submit comments electronically via the Internal Revenue Service INTERNET site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html). All submitted comments will be available for public inspection and copying.

**FURTHER INFORMATION:** For further information regarding this notice, contact Ms. Katherine A. Hossofsky at (202) 622-3970 (not a toll-free call).

**PROCEDURAL INFORMATION:** This document serves as an "administrative pronouncement" as that term is defined in § 1.6661-3(b)(2) of the Income Tax Regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

26 CFR 601.204: *Changes in accounting periods and in methods of accounting.*  
(Also Part I, §§ 446, 481; 1.446-1, 1.481-1, 1.481-4.)

## Rev. Proc. 97-27

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.01 <i>In general.</i> This revenue procedure provides the general procedures under § 446(e) of the Internal Revenue Code and § 1.446-1(e) of the Income Tax Regulations for obtaining the consent of the Commissioner of Internal Revenue to change a method of accounting for federal income tax purposes. This revenue procedure modifies	

and supersedes Rev. Proc. 92-20, 1992-1 C.B. 685.

#### .02 *Voluntary compliance.*

(1) This revenue procedure provides incentives to encourage prompt voluntary compliance with proper tax accounting principles. Under this approach, a taxpayer generally receives more favorable terms and conditions (for example, a later year of change and a longer § 481(a) adjustment period for a positive adjustment) if the taxpayer files its request for a change in accounting method before the Internal Revenue Service contacts the taxpayer for examination. A taxpayer that is contacted for examination and required to change its method of accounting by the Service generally receives less favorable terms and conditions and may also be subject to penalties.

(2) Although prompt voluntary compliance can generally be encouraged through incentives, the Service recognizes that this approach may not be appropriate or effective in all cases. For example, a number of taxpayers have deferred making changes required by amendments to the Internal Revenue Code or the Income Tax Regulations. Because it is generally not appropriate to permit changes on a basis more favorable than applicable under the governing statute or regulation, the Service may, in other published guidance, provide special terms and conditions that are designed to place the taxpayer in a position no more favorable than if the taxpayer had timely complied with the required change. See, for example, Rev. Proc. 93-48, 1993-2 C.B. 580 (regarding changes in method of accounting for notional principal contracts to comply with the requirements of § 1.446-3).

.03 *Significant changes.* Many of the complex rules and requirements of Rev. Proc. 92-20 have been simplified or eliminated. For example, the Category A, Category B, Designated A, and Designated B classifications have been eliminated, the 90-day window at the beginning of an examination has been eliminated, the 30-day window for taxpayers under continuous examination has been expanded to 90 days and the number of consecutive months the taxpayer is required to be under examination has been reduced from 18 to 12, the definition of “under examination” has been clarified, the consent requirement for taxpayers before an appeals office or a federal court has been replaced with a notification procedure, the various § 481(a) adjustment periods have been

replaced with a single 4-year § 481(a) adjustment period for both positive and negative adjustments, and several of the terms and conditions relating to the § 481(a) adjustment have been eliminated.

## SECTION 2. BACKGROUND

.01 *Change in method of accounting defined.*

(1) Section 1.446-1(e)(2)(ii)(a) provides that a change in method of accounting includes a change in the overall plan of accounting for gross income or deductions, or a change in the treatment of any material item. A material item is any item that involves the proper time for the inclusion of the item in income or the taking of the item as a deduction. In determining whether a taxpayer’s accounting practice for an item involves timing, generally the relevant question is whether the practice permanently changes the amount of the taxpayer’s lifetime income. If the practice does not permanently affect the taxpayer’s lifetime income, but does or could change the taxable year in which income is reported, it involves timing and is therefore a method of accounting. See Rev. Proc. 91-31, 1991-1 C.B. 566.

(2) Although a method of accounting may exist under this definition without a pattern of consistent treatment of an item, a method of accounting is not adopted in most instances without consistent treatment. The treatment of a material item in the same way in determining the gross income or deductions in two or more consecutively filed tax returns (without regard to any change in status of the method as permissible or impermissible) represents consistent treatment of that item for purposes of § 1.446-1(e)(2)(ii)(a). If a taxpayer treats an item properly in the first return that reflects the item, however, it is not necessary for the taxpayer to treat the item consistently in two or more consecutive tax returns to have adopted a method of accounting. If a taxpayer has adopted a method of accounting under these rules, the taxpayer may not change the method by amending its prior income tax return(s). See Rev. Rul. 90-38, 1990-1 C.B. 57.

(3) A change in the characterization of an item may also constitute a change in method of accounting if the change has the effect of shifting income from one period to another. For example, a change from treating an item as income to treating the item as a

deposit is a change in method of accounting. *See* Rev. Proc. 91-31.

(4) A change in method of accounting does not include correction of mathematical or posting errors, or errors in the computation of tax liability (such as errors in computation of the foreign tax credit, net operating loss, percentage depletion, or investment credit). *See* § 1.446-1(e)(2)(ii)(b).

.02 *Securing permission to make a method change.* Section 446(e) and § 1.446-1(e) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1T(e)(3)(i) requires that, in order to obtain the Commissioner's consent to a method change, a taxpayer must file a Form 3115, Application for Change in Accounting Method, during the taxable year in which the taxpayer desires to make the proposed change.

.03 *Terms and conditions of a method change.* Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e). The terms and conditions the Commissioner may prescribe include the year of change, whether the change is to be made with a § 481(a) adjustment or on a cut-off basis, and the § 481(a) adjustment period.

.04 *No retroactive method change.* Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in method of accounting, regardless of whether the change is from a permissible or an impermissible method. *See generally* Rev. Rul. 90-38.

.05 *Method change with a § 481(a) adjustment.*

(1) *Need for adjustment.* Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year. When there is a change in method of accounting to which § 481(a) is applied, income for the taxable year preceding the year of change must be determined under the method of accounting that was then employed, and income for the year of change and the following taxable years

must be determined under the new method of accounting as if the new method had always been used.

*Example.* A taxpayer that is not required to use inventories uses the overall cash receipts and disbursements method and changes to an overall accrual method. The taxpayer has \$120,000 of income earned but not yet received (accounts receivable) and \$100,000 of expenses incurred but not yet paid (accounts payable) as of the end of the taxable year preceding the year of change. A positive § 481(a) adjustment of \$20,000 (\$120,000 accounts receivable less \$100,000 accounts payable) is required as a result of the change.

(2) *Adjustment period.* Section 481(c) and §§ 1.446-1T(e)(3)(i) and 1.481-4 provide that the adjustment required by § 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer. Generally, in the absence of such an agreement, the § 481(a) adjustment is taken into account completely in the year of change, subject to § 481(b) which limits the amount of tax where the § 481(a) adjustment is substantial. However, under the Commissioner's authority in § 1.446-1(e)(3)(ii) to prescribe terms and conditions for changes in method of accounting, this revenue procedure provides specific adjustment periods that are intended to achieve an appropriate balance between the goals of mitigating distortions of income that result from accounting method changes and providing appropriate incentives for voluntary compliance.

.06 *Method change using a cut-off method.* The Commissioner may determine that certain changes in method of accounting will be made without a § 481(a) adjustment, using a "cut-off method." Under a cut-off method, only the items arising on or after the beginning of the year of change (or other operative date) are accounted for under the new method of accounting. Any items arising before the year of change (or other operative date) continue to be accounted for under the taxpayer's former method of accounting. *See, for example,* § 263A (which generally applies to costs incurred after December 31, 1986, for noninventory property), § 461(h) (which generally applies to amounts incurred on or after July 18, 1984), and § 1.446-3 (which applies to notional principal contracts entered into on or after December 13, 1993). Because no items are duplicated or omitted from income when a cut-off method is used to effect a change in accounting method, no § 481(a) adjustment is necessary.

.07 *Consistency and clear reflection of income.* Methods of accounting should clearly reflect income on a continuing basis, and the Service exercises its discretion under §§ 446(e) and 481(c) in a manner that generally minimizes distortions of income across taxable years and on an annual basis. Accordingly, if a taxpayer requests to change from a method of accounting that clearly reflects income, the Service, in determining whether to consent to the taxpayer's request, will weigh the need for consistency against the taxpayer's reason for desiring to change its method of accounting.

.08 *Separate trades or businesses.*

(1) Sections 1.446-1(d)(1) and (2) provide that when a taxpayer has two or more separate and distinct trades or businesses, a different method of accounting may be used for each trade or business, provided the method of accounting used for each trade or business clearly reflects the overall income of the taxpayer as well as that of each particular trade or business. No trade or business is separate and distinct unless a complete and separable set of books and records is kept for that trade or business.

(2) Section 1.446-1(d)(3) provides that if, by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses of the taxpayer (for example, through inventory adjustments, sales, purchases, or expenses) so that income of the taxpayer is not clearly reflected, the trades or businesses of the taxpayer are not separate and distinct.

.09 *Penalties.* Any otherwise applicable penalty for the failure of a taxpayer to change its method of accounting (for example, the accuracy-related penalty under § 6662 or the fraud penalty under § 6663) may be imposed if the taxpayer does not timely file a request to change a method of accounting. *See* § 446(f). Additionally, the taxpayer's return preparer may also be subject to the preparer penalty under § 6694. However, penalties will not be imposed when a taxpayer changes from an impermissible method of accounting to a permissible one by complying with all the appropriate provisions of this revenue procedure.

.10 *Change made as part of an examination.* Section 446(b) and § 1.446-1(b)(1) provide that if a taxpayer does not regularly employ a method of accounting that clearly reflects its income, the computation of taxable income must

be made in a manner that, in the opinion of the Commissioner, does clearly reflect income. If a taxpayer under examination is not eligible to change an accounting method under this revenue procedure, the change may be made by the district director. A change resulting in a positive § 481(a) adjustment will ordinarily be made in the earliest taxable year under examination with a one-year § 481(a) adjustment period.

### SECTION 3. DEFINITIONS

#### .01 *Taxpayer.*

(1) *In general.* The term “taxpayer” has the same meaning as the term “person” defined in § 7701(a)(1) (rather than the meaning of the term “taxpayer” defined in § 7701(a)(14)).

(2) *Consolidated group.* For purposes of (a) sections 3.07(1), 3.08(1), 4.02(2) and 6.01 (taxpayer under examination), (b) sections 3.08(2), 4.02(3) and 6.02 (taxpayer before an appeals office), or (c) sections 3.08(3), 4.02(4) and 6.03 (taxpayer before a federal court), the term “taxpayer” includes a consolidated group.

.02 *Filed.* Any form (including a Form 3115), statement, or other document required to be filed under this revenue procedure is filed on the date it is mailed to the proper address (or an address similar enough to complete delivery). If the form, statement, or other document is not mailed (or the date it is mailed cannot be reasonably determined), it is filed on the date it is delivered to the Service.

.03 *Mailed.* The date of mailing will be determined under the rules of § 7502. For example, the date of mailing is the date of the U.S. postmark or the applicable date recorded or marked by a designated delivery service. See Notice 97-26, 1997-17 I.R.B. 6.

.04 *Timely performance of acts.* The rules of § 7503 apply when the last day for the taxpayer’s timely performance of any act (for example, filing a Form 3115, submitting additional information, returning a Consent Agreement (see section 8.11 of this revenue procedure), or holding a conference) falls on a Saturday, Sunday, or legal holiday. The performance of any act is timely if the act is performed on the next succeeding day that is not a Saturday, Sunday, or a legal holiday.

.05 *Year of change.* The year of change is the taxable year for which a change in method of accounting is effective, that is, the first taxable year the

new method is to be used, even if no affected items are taken into account for that year. The year of change is also the first taxable year for complying with all the terms and conditions set forth in the Consent Agreement.

.06 *Section 481(a) adjustment period.* The § 481(a) adjustment period is the applicable number of taxable years for taking into account the § 481(a) adjustment required as a result of the change in method of accounting. The year of change is the first taxable year in the adjustment period and the § 481(a) adjustment is taken into account ratably over the number of taxable years in the adjustment period. The applicable adjustment periods are set forth in sections 5.02(3) and 6.04 of this revenue procedure.

#### .07 *Under examination.*

##### (1) *In general.*

(a) Except as provided in section 3.07(2) of this revenue procedure, an examination of a taxpayer with respect to a federal income tax return begins on the date the taxpayer is contacted in any manner by a representative of the Service for the purpose of scheduling any type of examination of the return. An examination ends:

(i) in a case in which the Service accepts the return as filed, on the date of the “no change” letter sent to the taxpayer;

(ii) in a fully agreed case, on the earliest of the date the taxpayer executes a waiver of restrictions on assessment or acceptance of overassessment (for example, Form 870, 4549, or 4605), the date the taxpayer makes a payment of tax that equals or exceeds the proposed deficiency, or the date of the “closing” letter (for example, Letter 891 or 987) sent to the taxpayer; or

(iii) in an unagreed or a partially agreed case, on the earliest of the date the taxpayer (or its representative) is notified by Appeals that the case has been referred to Appeals from Examination, the date the taxpayer files a petition in the Tax Court, the date on which the period for filing a petition with the Tax Court expires, or the date of the notice of claim disallowance.

(b) An examination does not end as a result of the early referral of an issue to Appeals under the provisions of Rev. Proc. 96-9, 1996-1 C.B. 575.

(c) An examination resumes on the date the taxpayer (or its representative) is notified by Appeals (or otherwise) that the case has been referred to Examination for reconsideration.

(2) *Partnerships and S corporations subject to TEFRA.* For an entity (including a limited liability company), treated as a partnership or an S corporation for federal income tax purposes, that is subject to the TEFRA unified audit and litigation provisions for partnerships and S corporations, an examination begins on the date of the notice of the beginning of an administrative proceeding sent to the Tax Matters Partner/Tax Matters Person (TMP). An examination ends:

(a) in a case in which the Service accepts the partnership or S corporation return as filed, on the date of the “no adjustments” letter or the “no change” notice of final administrative adjustment sent to the TMP;

(b) in a fully agreed case, when all the partners, members, or shareholders execute a Form 870-P, 870-L, or 870-S; or

(c) in an unagreed or a partially agreed case, on the earliest of the date the TMP (or its representative) is notified by Appeals that the case has been referred to Appeals from Examination, the date the TMP (or a partner, member, or shareholder) requests judicial review, or the date on which the period for requesting judicial review expires.

But see section 4.02(6) of this revenue procedure for certain rules that preclude an entity from requesting a change in accounting method. Also note that S corporations are not subject to the TEFRA unified audit and litigation provisions for taxable years beginning after December 31, 1996. See Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1317(a), 110 Stat. 1755, 1787 (1996).

#### .08 *Issue under consideration.*

(1) *Under examination.* A taxpayer’s method of accounting for an item is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example, by examination plan, information document request (IDR), or notification of proposed adjustments or income tax examination changes) from the examining agent(s) specifically citing the treatment of the item as an issue under consideration. For example, a taxpayer’s method of pooling under the dollar-value, last-in first-out LIFO inventory method is an issue under consideration as a result of an examination plan that identifies LIFO pooling as a matter to be examined, but it is not an issue under consideration as a result of an examination plan that merely identi-

fies LIFO inventories as a matter to be examined. Similarly, a taxpayer's method of determining inventoriable costs under § 263A is an issue under consideration as a result of an IDR that requests documentation supporting the costs included in inventoriable costs, but it is not an issue under consideration as a result of an IDR that requests documentation supporting the amount of cost of goods sold reported on the return. The question of whether a method of accounting is an issue under consideration may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 97-2, 1997-1 I.R.B. 64 (or any successor).

(2) *Before an appeals office.* A taxpayer's method of accounting for an item is an issue under consideration for the taxable years before an appeals office if the treatment of the item is included as an item of adjustment in the examination report referred to Appeals or is specifically identified in writing to the taxpayer by Appeals.

(3) *Before a federal court.* A taxpayer's method of accounting for an item is an issue under consideration for the taxable years before a federal court if the treatment of the item is included in the statutory notice of deficiency, the notice of claim disallowance, the notice of final administrative adjustment, the pleadings (for example, the petition, complaint, or answer) or amendments thereto, or is specifically identified in writing to the taxpayer by the counsel for the government.

.09 *Change within the LIFO inventory method.* A change within the LIFO inventory method is a change from one LIFO inventory method or sub-method to another LIFO inventory method or sub-method. A change within the LIFO inventory method does not include a change in method of accounting that could be made by a taxpayer that does not use the LIFO inventory method (for example, a method governed by § 471 or § 263A).

#### SECTION 4. SCOPE

.01 *Applicability.* Except as specifically provided in other published guidance or in section 4.02 of this revenue procedure, this revenue procedure applies to all taxpayers requesting the Commissioner's consent to change a method of accounting for federal income tax purposes.

.02 *Inapplicability.* This revenue procedure does not apply in the following situations:

(1) *Automatic change.* If the change in method of accounting is required to be made pursuant to a published automatic change procedure. Taxpayers are encouraged to review the automatic change procedures listed in section 9.03 of Rev. Proc. 97-1, 1997-1 I.R.B. 11, 37 (or any successor), before submitting a Form 3115 pursuant to this revenue procedure;

(2) *Under examination.* If the taxpayer is under examination, except as provided in sections 6.01(2) (90-day window), 6.01(3) (120-day window), and 6.01(4) (district director consent) of this revenue procedure;

(3) *Before an appeals office.* If the taxpayer is before an appeals office with respect to any income tax issue and the accounting method to be changed is an issue under consideration by the appeals office;

(4) *Before a federal court.* If the taxpayer is before a federal court with respect to any income tax issue and the accounting method to be changed is an issue under consideration by the federal court; or

(5) *Consolidated group member.* A corporation that is (or was formerly) a member of a consolidated group is under examination, before an appeals office, or before a federal court (for purposes of sections 4.02(2), (3), and (4) of this revenue procedure) if the consolidated group is under examination, before an appeals office, or before a federal court for a taxable year(s) that the corporation was a member of the group.

(6) *Partnerships and S corporations.* For an entity (including a limited liability company) treated as a partnership or an S corporation for federal income tax purposes, if the entity's accounting method to be changed is an issue under consideration in an examination of a partner, member, or shareholder's federal income tax return or an issue under consideration by an appeals office or by a federal court with respect to a partner, member, or shareholder's federal income tax return.

#### SECTION 5. PROCEDURES FOR TAXPAYERS NOT UNDER EXAMINATION

.01 *Submission of application.*

(1) *In general.*

(a) A Form 3115 must be filed during the year of change, as provided in § 1.446-1T(e)(3)(i). If the taxable year is a short period, the Form 3115 must be filed no later than the last day of the short taxable year.

(b) The Service recommends that the Form 3115 be filed as early as possible during the year of change to provide the Service adequate time to respond to the Form 3115 prior to the original due date of the taxpayer's return for the year of change.

(2) *Limited relief for late application.* A taxpayer that fails to file a Form 3115 during the year of change as provided in section 5.01(1) of this revenue procedure will not be granted an extension of time to file under § 301.9100 of the Procedure and Administration Regulations, except in unusual and compelling circumstances. See § 301.9100-3T(c)(2)(i).

.02 *Terms and conditions of change.*

(1) *In general.* Except as specifically provided in other published guidance, an accounting method change filed under this revenue procedure, if granted, must be made pursuant to the terms and conditions provided in this revenue procedure (including sections 8.02 and 13.02 of this revenue procedure).

(2) *Year of change.* The year of change is the taxable year with respect to which the Form 3115 is timely filed under section 5.01 of this revenue procedure. However, Rev. Proc. 93-48 (regarding notional principal contracts) is an example of other published guidance that provides for a different year of change.

(3) *Section 481(a) adjustment period.*

(a) *In general.* Except as provided in sections 5.02(3)(b) and 7.03 of this revenue procedure, the § 481(a) adjustment period for positive and negative § 481(a) adjustments is four taxable years.

(b) *Changes within the LIFO method.* Any change within the LIFO inventory method must be made using a cut-off method. However, Announcement 91-173, 1991-47 I.R.B. 29 (regarding LIFO taxpayers changing their method of accounting for certain bulk bargain purchases of inventory to comply with *Hamilton Industries, Inc. v. Commissioner*, 97 T.C. 120 (1991)) is an example of other published guidance that requires a § 481(a) adjustment.

(4) *NOL carryback limitation for taxpayer subject to criminal investigation.* Generally, no portion of any net

operating loss that is attributable to a negative § 481(a) adjustment may be carried back to a taxable year prior to the year of change that is the subject of any pending or future criminal investigation or proceeding concerning (a) directly or indirectly, any issue relating to the taxpayer's federal tax liability, or (b) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability.

(5) *Change treated as initiated by the taxpayer.* For purposes of § 481, an accounting method change filed under this revenue procedure, if granted, is a change in method of accounting initiated by the taxpayer.

## SECTION 6. PROCEDURES FOR TAXPAYERS UNDER EXAMINATION, BEFORE AN APPEALS OFFICE, OR BEFORE A FEDERAL COURT

### .01 *Taxpayer under examination.*

(1) *In general.* A taxpayer that is under examination may not file a Form 3115 to request a change in accounting method under this revenue procedure, except as provided in sections 6.01(2) (90-day window), 6.01(3) (120-day window), and 6.01(4) (district director consent) of this revenue procedure. A taxpayer that files a Form 3115 beyond the time periods provided in the 90-day and 120-day windows will not be granted an extension of time to file under § 301.9100, except in unusual and compelling circumstances.

#### (2) *90-day window period.*

(a) A taxpayer may file a Form 3115 to request a change in accounting method during the first 90 days of any taxable year ("90-day window") if the taxpayer has been under examination for at least 12 consecutive months as of the first day of the taxable year. This 90-day window is not available if the method of accounting the taxpayer is requesting to change is an issue under consideration at the time the Form 3115 is filed or is an issue the examining agent(s) has placed in suspense at the time the Form 3115 is filed.

(b) A taxpayer requesting a change under this 90-day window must provide a copy of the Form 3115 to the examining agent(s) at the same time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent(s). The taxpayer must attach to the Form 3115 a

separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration or an issue placed in suspense by the examining agent(s).

#### (3) *120-day window period.*

(a) A taxpayer may file a Form 3115 to request a change in accounting method during the 120-day period following the date an examination ends ("120-day window") regardless of whether a subsequent examination has commenced. This 120-day window is not available if the method of accounting the taxpayer is requesting to change is an issue under consideration at the time the Form 3115 is filed or is an issue the examining agent(s) has placed in suspense at the time the Form 3115 is filed.

(b) A taxpayer requesting a change under this 120-day window must provide a copy of the Form 3115 to the examining agent(s) for any examination that is in process at the same time it files the original Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent(s). The taxpayer must attach to the Form 3115 a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration or an issue placed in suspense by the examining agent(s).

#### (4) *Consent of district director.*

(a) A taxpayer under examination may request to change an accounting method under this revenue procedure if the district director consents to the filing of the request. The district director will consent to the filing of the Form 3115 unless, in the opinion of the district director, the method of accounting to be changed would ordinarily be included as an item of adjustment in the year(s) for which the taxpayer is under examination. For example, the district director will consent to the filing of a Form 3115 to change from a clearly permissible method of accounting. The district director will also consent to the filing of a Form 3115 to change from an impermissible method of accounting where the impermissible method was adopted subsequent to the years under examination. The question of whether the method of accounting from which the taxpayer is changing is permissible or was adopted subsequent to the years under examination may be referred to the national office as a request for

technical advice under the provisions of Rev. Proc. 97-2 (or any successor).

(b) A taxpayer requesting a change with the consent of the district director must attach to the Form 3115 a statement from the district director consenting to the taxpayer filing the Form 3115. The taxpayer must provide a copy of the Form 3115 to the district director at the same time it files the original of that form with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent(s).

.02 *Taxpayer before an appeals office.* A taxpayer that is before an appeals office with respect to any income tax issue may request a change in accounting method if the accounting method to be changed is not an issue under consideration by the appeals office. The taxpayer must attach to the Form 3115 a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration by the appeals office. The taxpayer must provide a copy of the Form 3115 to the appeals officer at the same time it files the original Form 3115 with the national office. The Form 3115 must contain the name and telephone number of the appeals officer.

.03 *Taxpayer before a federal court.* A taxpayer that is before a federal court with respect to any income tax issue may request a change in accounting method if the accounting method to be changed is not an issue under consideration by the federal court. The taxpayer must attach to the Form 3115 a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the same method of accounting is not an issue under consideration by the federal court. The taxpayer must provide a copy of the Form 3115 to the counsel for the government at the same time it files the original Form 3115 with the national office. The Form 3115 must contain the name and telephone number of the counsel for the government.

.04 *Terms and conditions of change.* For a taxpayer under examination filing a Form 3115 during the 90-day or 120-day window, or with the consent of the district director, or for a taxpayer before an appeals office or a federal court, the terms and conditions are the same as those provided in section 5.02 of this revenue procedure for taxpayers not under examination.



## SECTION 7. SECTION 481(a) ADJUSTMENT PERIOD

.01 *In general.* The § 481(a) adjustment periods are provided in sections 5.02(3) and 6.04 of this revenue procedure.

.02 *Short period as a separate taxable year.* If the year of change, or any taxable year during the § 481(a) adjustment period, is a short taxable year, the § 481(a) adjustment must be included in income as if that short taxable year were a full 12-month taxable year. *See* Rev. Rul. 78-165, 1978-1 C.B. 276.

*Example 1.* A calendar year taxpayer received permission to change an accounting method beginning with the 1997 calendar year. The § 481(a) adjustment is \$30,000 and the adjustment period is four taxable years. The taxpayer subsequently receives permission to change its annual accounting period to September 30, effective for the taxable year ending September 30, 1998. The taxpayer must include \$7,500 of the § 481(a) adjustment in gross income for the short period from January 1, 1998, through September 30, 1998.

*Example 2.* Corporation X, a calendar year taxpayer, received permission to change an accounting method beginning with the 1997 calendar year. The § 481(a) adjustment is \$30,000 and the adjustment period is four taxable years. On July 1, 1999, Corporation Z acquires Corporation X in a transaction to which § 381(a) applies. Corporation Z is a calendar year taxpayer that uses the same method of accounting to which Corporation X changed in 1997. Corporation X must include \$7,500 of the § 481(a) adjustment in gross income for its short period income tax return for January 1, 1999, through June 30, 1999. In addition, Corporation Z must include \$7,500 of the § 481(a) adjustment in gross income in its income tax return for calendar year 1999.

.03 *Shortened or accelerated adjustment periods.* The four-year § 481(a) adjustment period provided in sections 5.02(3) and 6.04 of this revenue procedure will be shortened or accelerated in the following situations.

(1) *De minimis rule.* A taxpayer may elect to use a one-year adjustment period in lieu of the § 481(a) adjustment period otherwise provided by this revenue procedure if the entire § 481(a) adjustment is less than \$25,000 (either positive or negative). The taxpayer must complete the appropriate line on the Form 3115 to elect this *de minimis* rule.

(2) *Cooperatives.* A cooperative within the meaning of § 1381(a) generally must take the entire amount of a § 481(a) adjustment into account in computing taxable income for the year of change. *See* Rev. Rul. 79-45, 1979-1 C.B. 284.

(3) *Ceasing to engage in the trade or business.*

(a) *In general.* A taxpayer that ceases to engage in a trade or business

or terminates its existence must take the remaining balance of any § 481(a) adjustment relating to the trade or business into account in computing taxable income in the taxable year of the cessation or termination. Except as provided in sections 7.03(3)(d) and (e) of this revenue procedure, a taxpayer is treated as ceasing to engage in a trade or business if the operations of the trade or business cease or substantially all the assets of the trade or business are transferred to another taxpayer. For this purpose, "substantially all" has the same meaning as in section 3.01 of Rev. Proc. 77-37, 1977-2 C.B. 568.

(b) *Examples of transactions that are treated as the cessation of a trade or business.* The following is a nonexclusive list of transactions that are treated as the cessation of a trade or business for purposes of accelerating the § 481(a) adjustment under this section 7.03(3):

(i) the trade or business to which the § 481(a) adjustment relates is incorporated;

(ii) the trade or business to which the § 481(a) adjustment relates is purchased by another taxpayer in a transaction to which § 1060 applies;

(iii) the trade or business to which the § 481(a) adjustment relates is terminated or transferred pursuant to a taxable liquidation;

(iv) a division of a corporation ceases to operate the trade or business to which the § 481(a) adjustment relates; or

(v) the assets of a trade or business to which the § 481(a) adjustment relates are contributed to a partnership.

(c) *Conversion to or from S corporation status.*

(i) *In general.* Except as provided in sections 7.03(3)(c)(ii) and (iii) of this revenue procedure, no acceleration of a § 481(a) adjustment is required under this section 7.03(3)(c) when a C corporation elects to be treated as an S corporation or an S corporation terminates its S election and is then treated as a C corporation.

(ii) *S election effective for year of LIFO discontinuance.* If a C corporation elects to be treated as an S corporation for the taxable year in which it discontinues use of the LIFO inventory method, § 1363(d) requires an increase in the taxpayer's gross income for the LIFO recapture amount (as defined in § 1363(d)(3)) for the taxable year preceding the year of change (the

taxpayer's last taxable year as a C corporation), and a corresponding adjustment to the basis of the taxpayer's inventory as of the end of the taxable year preceding the year of change. Any increase in income tax as a result of the inclusion of the LIFO recapture amount is payable in four equal installments, beginning with the taxpayer's last taxable year as a C corporation as provided in § 1363(d)(2). Any corresponding basis adjustment is taken into account in computing the § 481(a) adjustment (if any) that results upon the discontinuance of the LIFO method by the corporation.

(iii) *S election effective for a year after LIFO discontinuance.* If a C corporation elects to be treated as an S corporation for a taxable year after the taxable year in which it discontinued use of the LIFO inventory method, the remaining balance of any positive § 481(a) adjustment must be included in its gross income in its last taxable year as a C corporation. If this inclusion results in an increase in tax for its last taxable year as a C corporation, this increase in tax is payable in four equal installments, beginning with the taxpayer's last taxable year as a C corporation as provided in § 1363(d)(2), unless the taxpayer is required to take the remaining balance of the § 481(a) adjustment into account in the last taxable year as a C corporation under another acceleration provision in section 7.03(3) of this revenue procedure.

(d) *Certain transfers to which § 381(a) applies.* No acceleration of the § 481(a) adjustment is required under this section 7.03(3) when a taxpayer transfers substantially all the assets of the trade or business that gave rise to the § 481(a) adjustment to another taxpayer in a transfer to which § 381(a) applies and the accounting method (the change to which gave rise to the § 481(a) adjustment) is a tax attribute that is carried over and used by the acquiring corporation immediately after the transfer pursuant to § 381(c). The acquiring corporation is subject to any terms and conditions imposed on the transferor (or any predecessor of the transferor) as a result of its change in method of accounting.

(e) *Certain transfers pursuant to § 351 within a consolidated group.*

(i) *In general.* No acceleration of the § 481(a) adjustment is required under this section 7.03(3) when one member of an affiliated group filing a consolidated return transfers substantially all the assets of the trade or



business that gave rise to the § 481(a) adjustment to another member of the same consolidated group in an exchange qualifying under § 351 and the transferee member adopts and uses the same method of accounting (the change to which gave rise to the § 481(a) adjustment) used by the transferor member. The transferor member must continue to take the § 481(a) adjustment into account pursuant to the terms and conditions set forth in its Consent Agreement (as provided in section 8.11 of this revenue procedure). The transferor member must take into account activities of the transferee member (or any successor) in determining whether acceleration of the § 481(a) adjustment is required. For example, except as provided in the following sentence, the transferor member must take any remaining § 481(a) adjustment into account in computing taxable income in the taxable year in which the transferee member ceases to engage in the trade or business to which the § 481(a) adjustment relates. The § 481(a) adjustment is not accelerated when the transferee member engages in a transaction described in section 7.03(3)(d) or section 7.03(3)(e)(i) of this revenue procedure.

(ii) *Exception.* The provisions of section 7.03(3)(e)(i) of this revenue procedure cease to apply and the transferor member must take any remaining balance of the § 481(a) adjustment into account in the taxable year immediately preceding any of the following: (A) the taxable year the transferor member ceases to be a member of the group; (B) the taxable year any transferee member owning substantially all the assets of the trade or business which gave rise to the § 481(a) adjustment ceases to be a member of the group; or (C) a separate return year of the common parent of the group. In applying the preceding sentence, the rules of paragraphs (j)(2), (j)(5), and (j)(6) of § 1.1502-13 apply, but only if the method of accounting to which the transferor member changed and to which the § 481(a) adjustment relates is adopted, carried over, or used by any transferee member acquiring the assets of the trade or business that gave rise to the § 481(a) adjustment immediately after acquisition of such assets. For example, the transferor member is not required to accelerate the § 481(a) adjustment if a transferee member ceases to be a member of a consolidated group by reason of an acquisition to which § 381(a) applies and the acquiring cor-

poration (A) is a member of the same group as the transferor member, and (B) continues, under § 381(c)(4) and the regulations thereunder, to use the same method of accounting as that used by the transferor member with respect to the assets of the trade or business to which the § 481(a) adjustment relates.

## SECTION 8. GENERAL APPLICATION PROCEDURES

.01 *Application—Service discretion.* The Service reserves the right to decline to process any Form 3115 filed under this revenue procedure in situations in which it would not be in the best interest of sound tax administration to permit the requested change. In this regard, the Service will consider whether the change in method of accounting would clearly and directly frustrate compliance efforts of the Service in administering the income tax laws.

.02 *Terms and conditions—Service discretion.* Except as specifically provided in other published guidance, a change in method of accounting filed under this revenue procedure, if granted, must be made pursuant to the terms and conditions provided in this revenue procedure. Notwithstanding this general rule, the Service may determine that, based on the unique facts of a particular case and in the interest of sound tax administration, terms and conditions that differ from those provided in this revenue procedure are more appropriate for a change made under this revenue procedure.

.03 *Compliance with provisions.* If a taxpayer changes its method of accounting without authorization or without complying with all the provisions of this revenue procedure, the taxpayer has initiated a change in method of accounting without obtaining the consent of the Commissioner required by § 446(e). Upon examination, a taxpayer that has initiated an unauthorized change in method of accounting may be required to effect the change in an earlier or later taxable year and may be denied the benefit of spreading the § 481(a) adjustment over the number of taxable years otherwise prescribed by this revenue procedure.

.04 *Facts and circumstances considered in processing applications.* In processing an application for a change in method of accounting, the Service will consider all the facts and circumstances, including:

(1) if the method of accounting requested is consistent with the Code, regulations, revenue rulings, revenue procedures, and decisions of the United States Supreme Court;

(2) if the use of the method of accounting requested will clearly reflect income;

(3) if the present method of accounting clearly reflects income;

(4) the need for consistency in the accounting area (see section 2.07 of this revenue procedure);

(5) the taxpayer's reason(s) for the change;

(6) the tax effect of the § 481(a) adjustment;

(7) if the taxpayer's books and records and financial statements will conform to the proposed method of accounting; and

(8) if the taxpayer previously requested to change its method of accounting for the same item but did not make the change.

.05 *Specific rules in connection with prior applications.*

(1) *Method change made.*

(a) *In general.* If the taxpayer changed its method of accounting for the same item within the four taxable years preceding the year of change (under either an automatic change procedure or a procedure requiring advance consent), a copy of the application for the previous change, the signed Consent Agreement (see section 8.11 of this revenue procedure) if applicable, and any other correspondence from the Service, must be attached to the Form 3115 filed for the subsequent taxable year. An explanation must be furnished stating why the taxpayer is again requesting to change its method of accounting for the same item. The Service will consider the explanation in determining whether the subsequent request for change in method of accounting will be granted.

(b) *LIFO inventory method change.* If a taxpayer previously received permission from the Commissioner to change from the LIFO inventory method, the Commissioner will not consent to the taxpayer's readoption of the LIFO inventory method for five taxable years (beginning with the taxable year the taxpayer changed from the LIFO inventory method), in the absence of a showing of unusual and compelling circumstances.

(2) *Method change not made.* If a prior Form 3115 (filed under either an automatic change procedure or a procedure requiring advance consent) was

withdrawn, not perfected, or denied, or if a Consent Agreement (see section 8.11 of this revenue procedure) was sent to the taxpayer but was not signed and returned to the Service, or if the change was not made, and the taxpayer files another application to change the same item for a year of change within four taxable years of the prior application, a copy of the earlier application (that is, the first Form 3115), together with any correspondence from the Service, must be attached to the Form 3115 filed for the subsequent taxable year. An explanation must be furnished stating why the earlier application was withdrawn or not perfected, or why the change was not made. The Service will consider the explanation in determining whether the subsequent request for change in method of accounting will be granted.

**.06 Where to file.** A taxpayer, other than an exempt organization, applying for a change in accounting method pursuant to this revenue procedure must complete and file a current Form 3115, together with the appropriate user fee, with the Commissioner of Internal Revenue, Attention: CC:DOM:CORP:T, P.O. Box 7604, Benjamin Franklin Station, Washington, DC 20044. An exempt organization must complete and file a current Form 3115, together with the appropriate user fee, with the Assistant Commissioner (Employee Plans and Exempt Organizations), Attention: E:EO, P.O. Box 120, Benjamin Franklin Station, Washington, DC 20044.

**.07 User fee.** Taxpayers are required to pay user fees for requests for changes in accounting method made under this revenue procedure. Rev. Proc. 97-1 (or any successor) contains the schedule of user fees and provides guidance for administering the user fee requirements.

**.08 Signature requirements.** The Form 3115 must be signed by, or on behalf of, the taxpayer requesting the change by an individual with authority to bind the taxpayer in such matters. For example, an officer must sign on behalf of a corporation, a general partner on behalf of a state law partnership, a member-manager on behalf of a limited liability company, a trustee on behalf of a trust, or an individual taxpayer on behalf of a sole proprietorship. If the taxpayer is a member of a consolidated group, a Form 3115 submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. See the signature requirements set forth in the General Instructions attached to a current Form 3115 regarding those who

are to sign. If an agent is authorized to represent the taxpayer before the Service, receive the original or a copy of the correspondence concerning the request, or perform any other act(s) regarding the Form 3115 filed on behalf of the taxpayer, a power of attorney reflecting such authorization(s) must be attached to the Form 3115. A taxpayer's representative without a power of attorney to represent the taxpayer as indicated in this section will not be given any information regarding the Form 3115.

**.09 Incomplete Form 3115—21 day rule.** If the Service receives a Form 3115 that is not properly completed in accordance with the instructions on the Form 3115 and the provisions of this revenue procedure, or if supplemental information is needed, the Service will notify the taxpayer. The notification will specify the information that needs to be provided, and the taxpayer will be permitted 21 days from the date of the notification to furnish the necessary information. The Service reserves the right to impose shorter reply periods if subsequent requests for additional information are made. If the required information is not submitted to the Service within the reply period, the Form 3115 will not be processed. An additional period, not to exceed 15 days, to furnish information may be granted to a taxpayer. The request for an extension of time must be made in writing and submitted within the 21-day period. If the extension request is denied, there is no right of appeal.

**.10 Conference in the national office.** The taxpayer must complete the appropriate line on the Form 3115 to request a conference of right if an adverse response is contemplated by the Service. If the taxpayer does not complete the appropriate line on the Form 3115 or request a conference in a later written communication, the Service will presume that the taxpayer does not desire a conference. If requested, a conference will be arranged in the national office prior to the Service's formal reply to the taxpayer's Form 3115. For taxpayers other than exempt organizations, see section 11 of Rev. Proc. 97-1 (or any successor). For exempt organizations, see section 12 of Rev. Proc. 97-4, 1997-1 I.R.B. 96 (or any successor).

**.11 Consent Agreement.**

(1) *In general.* Unless otherwise specifically provided, the Commissioner's permission to change a taxpayer's method of accounting for a specific

taxable year will be set forth in a ruling letter (original and one copy) from the national office that identifies the item or items being changed, the § 481(a) adjustment (if any), and the terms and conditions under which the change is to be effected for the taxable year specified in the ruling letter. See §§ 1.446-1(e)(3) and 1.481-4. If the taxpayer agrees to the terms and conditions contained in the ruling letter, the taxpayer must sign and date the agreement copy of the ruling letter in the appropriate space. The signed copy of the ruling letter will constitute an agreement (Consent Agreement) within the meaning of § 481(c) and as required by § 1.481-4(b). The Consent Agreement must be returned to the address provided in the Consent Agreement within 45 days of the date of its issuance. In addition, a copy of the Consent Agreement must be attached to the taxpayer's income tax return for the year of change. If a taxpayer signs and returns the Consent Agreement, the taxpayer must implement the change in accounting method in accordance with the terms and conditions provided in the Consent Agreement and this revenue procedure. See § 1.481-4(b).

(2) *Signature requirements.* The Consent Agreement must be signed by, or on behalf of, the taxpayer making the request. The individual signing the Consent Agreement must have the authority to bind the taxpayer in such matters (in general, it may not be signed by the taxpayer's representative).

(3) *45-day requirement.* If the taxpayer does not return the signed Consent Agreement within 45 days of the date of its issuance, the ruling letter granting permission for the change will be null and void.

(4) *Change in method of accounting not made by the taxpayer.*

(a) If the taxpayer decides not to effect the change in accordance with the terms and conditions of the ruling letter, the taxpayer must so indicate by returning the ruling letter and the unsigned Consent Agreement to the national office addressed as follows: Commissioner of Internal Revenue, Attention: [Individual whose name and symbols appear at the top of the Consent Agreement], P.O. Box 14095, Benjamin Franklin Station, Washington, DC 20044, with an explanation of why the accounting method change will not be effected.

(b) If the taxpayer disagrees with the terms and conditions of the ruling letter, the taxpayer must express the disagreement together with an expla-

nation of the reason(s) within the 45-day period set forth above. The Service will consider the reason(s) for disagreement and notify the taxpayer whether the original ruling letter will be modified. If the ruling letter is not modified, the taxpayer will be notified and given 15 days from the date of the notification either to accept the original ruling letter by signing and returning the Consent Agreement, or to reject the change by returning the ruling letter and the unsigned Consent Agreement to the address in section 8.11(4)(a) of this revenue procedure.

*.12 Two or more trades or businesses.*

(1) *In general.* Sections 1.446-1(d)(1) and (2) permit different methods of accounting to be used for each trade or business of a taxpayer. However, in considering whether to grant an accounting method change for one of the trades or businesses of a taxpayer, the Service will consider whether the change will result in the creation or shifting of profits or losses between the trades or businesses, and whether the proposed method will clearly reflect the taxpayer's income as required under § 446 and the regulations thereunder.

(2) *Information required.* A taxpayer requesting a change in method of accounting for one of its trades or businesses must identify all other trades or businesses by name and the method of accounting used by each trade or business for the particular item that is the subject of the requested change in method of accounting.

(3) *Separate Forms 3115 required.* If a taxpayer operates two or more separate and distinct trades or businesses and has kept separable books and records (and employed different methods of accounting for the businesses), a Form 3115 and separate user fee is required for each separate trade or business should the taxpayer desire to change the methods of accounting of the separate trades or businesses.

*.13 Consolidated groups.*

(1) *In general.* Section 1.1502-17(a) permits separate methods of accounting to be used by each member of a consolidated group, subject to the provisions of § 446 and the regulations thereunder. However, in considering whether to grant accounting method changes to group members, the Service will consider the effects of the changes on the income of the group. A common parent requesting a change in method of accounting on behalf of a member of

the consolidated group must submit any information necessary to permit the Service to evaluate the effect of the requested change on the income of the consolidated group. Except as provided in section 8.13(2) of this revenue procedure, a Form 3115 and separate user fee must be submitted for each member of the group for which a change in accounting method is requested pursuant to this revenue procedure.

(2) *Separate Forms 3115 not required.* A common parent may request an identical accounting method change on a single Form 3115 on behalf of more than one member of a consolidated group at a reduced user fee. To qualify, the taxpayers in the consolidated group must be members of the same affiliated group under § 1504(a) that join in the filing of a consolidated tax return, and they must be requesting to change from the identical present method of accounting to the identical proposed method of accounting. All aspects of the requested accounting method change, including the present and proposed methods, the underlying facts, and the authority for the request, must be identical, except for the § 481(a) adjustment. See section 15.07(1) and (3) of Rev. Proc. 97-1 at 48-49 (or any successor) for the information required to be submitted with the Form 3115.

*.14 Applicability of Rev. Proc. 97-1 and Rev. Proc. 97-4.* Rev. Proc. 97-1 and Rev. Proc. 97-4 (or any successors), respectively, are applicable to a Form 3115 filed under this revenue procedure, unless specifically excluded or overridden by other published guidance (including the special procedures in this document).

*.15 Effect on other offices of the Service.* The provisions of this revenue procedure are not intended to preclude an appropriate representative of the Service (for example, an appeals official with delegated settlement authority) from settling a particular taxpayer's case involving an accounting method issue by agreeing to terms and conditions that differ from those provided in this revenue procedure when it is in the best interest of the government to do so.

## SECTION 9. AUDIT PROTECTION FOR TAXABLE YEARS PRIOR TO YEAR OF CHANGE

*.01 In general.* Except as provided in section 9.02 of this revenue procedure, when a taxpayer timely files a Form

3115 pursuant to this revenue procedure, the Service will not require the taxpayer to change its method of accounting for the same item for a taxable year prior to the year of change.

*.02 Exceptions.*

(1) *Change not made or made improperly.* The Service may change a taxpayer's method of accounting for prior taxable years if (a) the taxpayer withdraws or does not perfect its request, (b) the national office denies the request, (c) the taxpayer declines to implement the change in method of accounting pursuant to the terms and conditions of the Consent Agreement and this revenue procedure, (d) the taxpayer implements the change but does not comply with the terms and conditions contained in the Consent Agreement and this revenue procedure, or (e) the national office modifies or revokes the ruling retroactively because there has been a misstatement or an omission of material facts. See section 10.02(2) of this revenue procedure.

(2) *Change in sub-method.* The Service may change a taxpayer's method of accounting for prior taxable years if the taxpayer is changing a sub-method of accounting within the method. For example, an examining agent may propose to terminate the taxpayer's use of the LIFO inventory method during a prior taxable year even though the taxpayer changes its method of valuing increments in the current year.

(3) *Prior year Service-initiated change.* The Service may make adjustments to the taxpayer's returns for the same item for taxable years prior to the requested year of change to reflect a prior year Service-initiated change.

(4) *Criminal investigation.* The Service may change a taxpayer's method of accounting for the same item for taxable years prior to the requested year of change if there is any pending or future criminal investigation or proceeding concerning (a) directly or indirectly, any issue relating to the taxpayer's federal tax liability for any taxable year prior to the year of change, or (b) the possibility of false or fraudulent statements made by the taxpayer with respect to any issue relating to its federal tax liability for any taxable year prior to the year of change.

## SECTION 10. EFFECT OF CONSENT

*.01 In general.* A taxpayer that changes to a method of accounting pursuant to this revenue procedure may

be required to change or modify that method of accounting for the following reasons:

- (1) the enactment of legislation;
- (2) a decision of the United States Supreme Court;
- (3) the issuance of temporary or final regulations;
- (4) the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin;
- (5) the issuance of written notice to the taxpayer that the change in method of accounting was granted in error or is not in accord with the current views of the Service; or
- (6) a change in the material facts on which the consent was based.

**.02 Retroactive change or modification.** Except in rare or unusual circumstances, if a taxpayer that changes its method of accounting under this revenue procedure is subsequently required under this section 10 to change or modify that method of accounting, the required change or modification will not be applied retroactively provided that:

- (1) the taxpayer complied with all the applicable provisions of the Consent Agreement and this revenue procedure;
- (2) there has been no misstatement or omission of material facts;
- (3) there has been no change in the material facts on which the consent was based;
- (4) there has been no change in the applicable law; and
- (5) the taxpayer to whom consent was granted acted in good faith in relying on the consent, and applying the change or modification retroactively would be to the taxpayer's detriment.

## SECTION 11. REVIEW BY DISTRICT DIRECTOR

**.01 In general.** The district director must apply a ruling obtained under this revenue procedure in determining the taxpayer's liability unless the district director recommends that the ruling should be modified or revoked. The district director will ascertain if:

- (1) the representations on which the ruling was based reflect an accurate statement of the material facts;
- (2) the amount of the § 481(a) adjustment was properly determined;
- (3) the change in method of accounting was implemented as proposed in accordance with the terms and conditions of the Consent Agreement and this revenue procedure;

(4) there has been any change in the material facts on which the ruling was based during the period the method of accounting was used; and

(5) there has been any change in the applicable law during the period the method of accounting was used.

**.02 National office consideration.** If the district director recommends that the ruling (other than the amount of the § 481(a) adjustment) should be modified or revoked, the district director will forward the matter to the national office for consideration before any further action is taken. Such a referral to the national office will be treated as a request for technical advice, and the provisions of Rev. Proc. 97-2 (or any successor) will be followed.

## SECTION 12. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, 1111 Constitution Avenue, NW, Washington, DC 20224.

## SECTION 13. EFFECTIVE DATE

**.01 In general.** Except as provided in section 13.02(1) of this revenue procedure, this revenue procedure is effective for Forms 3115 filed on or after May 15, 1997.

**.02 Transition rules.**

(1) **Currently pending Forms 3115.** If a taxpayer filed a Form 3115 under Rev. Proc. 92-20 for a taxable year ending on or after May 15, 1997, and the Form 3115 is pending with the national office on May 15, 1997, the taxpayer may apply the terms and conditions (exclusive of the year of change) in this revenue procedure. However, the national office will apply the terms and conditions in Rev. Proc. 92-20, unless, prior to the later of June 15, 1997, or the issuance of the letter ruling granting or denying consent to the change, the taxpayer notifies the national office that it requests to apply the terms and conditions (exclusive of the year of change) in this revenue procedure.

(2) **New Forms 3115.** Except as provided in section 13.02(3) of this revenue procedure, a taxpayer that files a Form 3115 under this revenue procedure on or before December 31, 1997, may apply the terms and conditions (exclusive of the year of change) in Rev. Proc. 92-20. The taxpayer must affirmatively state in an attachment to the Form 3115 (a) that it requests to apply the terms and conditions (exclusive of the

year of change) in Rev. Proc. 92-20, and (b) the applicable § 481(a) adjustment period and the authority therefor.

(3) **Open window periods under Rev. Proc. 92-20.** If, on May 15, 1997, a taxpayer is within a window period provided in Rev. Proc. 92-20, the taxpayer may file a Form 3115 under this revenue procedure during the remainder of that window period and apply the terms and conditions in Rev. Proc. 92-20 for the applicable window period. The taxpayer must affirmatively state in an attachment to the Form 3115 (a) that it agrees to apply the terms and conditions of the applicable window period in Rev. Proc. 92-20, and (b) the applicable § 481(a) adjustment period and the authority therefor.

## SECTION 14. EFFECT ON OTHER DOCUMENTS

**.01 Rev. Proc. 92-20.** Except as provided in section 14.02 of this revenue procedure, Rev. Proc. 92-20 is modified and, as modified, is superseded.

**.02 Rev. Proc. 93-48 (notional principal contracts).** The Designated A method provisions of Rev. Proc. 92-20 continue to apply to changes in method of accounting for notional principal contracts made pursuant to the requirements of § 1.446-3 and Rev. Proc. 93-48.

**.03 Notice 89-15 (long-term contracts).** Q&A 13 of Notice 89-15, 1989-1 C.B. 634, 637, regarding changes in method of accounting for long-term contracts under § 460, is modified and, as modified, is superseded.

## SECTION 15. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1541.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this revenue procedure are in sections 6, 8, and 13. This information is required to determine whether the taxpayer's proposed method of accounting is permissible. This information will be used by the Service to determine whether to consent to a change in accounting method and the appropriate terms and

conditions for the change. The collections of information are required to obtain consent to the accounting method change. The likely respondents are the following: individuals, farms, business or other for-profit organizations, non-profit institutions, and small businesses or organizations.

The estimated total annual reporting burden is 9,633 hours.

The estimated annual burden per respondent varies from 1/4 of an hour to 5

hours, depending on individual circumstances, with an estimated average of 3 1/4 hours. The estimated number of respondents is 3,000.

The estimated annual frequency of responses is occasional.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confiden-

tial, as required by 26 U.S.C. 6103.

#### DRAFTING INFORMATION

The author of this revenue procedure is Robert A. Testoff of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Testoff on (202) 622-4990 (not a toll-free call).

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## Part IV. Items of General Interest

### Extension of Test of Employment Tax Early Referral Procedures for Appeals

#### Announcement 97-52

**SUMMARY:** This document extends the test of the employment tax early referral procedures set forth in Announcement 96-13, 1996-12 I.R.B. 33, for an additional one-year period beginning on May 27, 1997, the date this Announcement is published in the Internal Revenue Bulletin.

**FOR FURTHER INFORMATION CONTACT:** Thomas Carter Louthan, Director, Office of Dispute Resolution and Specialty Programs, National Office Appeals, (202) 401-4098 (not a toll-free number).

#### EXTENSION OF TEST OF EMPLOYMENT TAX EARLY REFERRAL PROCEDURES FOR APPEALS

**Summary:** This Announcement is part of the Internal Revenue Service's strategy designed to improve employment tax administration for all taxpayers, including those who are small business owners. The purpose of early referral for employment tax issues is to resolve them more expeditiously through simultaneous action by the District and Appeals. Announcement 96-13 describes the method by which a taxpayer requests early referral of one or more unagreed employment tax issues from the District to Appeals. A taxpayer may request early referral of any developed, unagreed employment tax issue, including the application of section 530 of the Revenue Act of 1978, that is under the jurisdiction of the District Director arising from an audit.

This document extends the test of the procedure set forth in Announcement 96-13 for an additional one-year period beginning on May 27, 1997, the date this Announcement is published in the Internal Revenue Bulletin.

**Background:** Section 530 of the Revenue Act of 1978 provides businesses with relief from federal employment tax obligations if certain requirements are met. It terminates the business's, not the worker's, employment tax liability under Internal Revenue Code Subtitle C (Federal Insurance Contributions Act and Federal Unemployment Tax Act taxes, federal income tax withholding, and

Railroad Retirement Tax Act taxes) and any interest or penalties attributable to the liability for employment taxes (Rev. Proc. 85-18, 1985-1 C.B. 518).

Section 530(e)(3) of the Revenue Act of 1978, as amended by the Small Business Job Protection Act of 1996, generally effective after December 31, 1996, clarifies that the first step in any case involving whether the business has the employment tax obligations of an employer with respect to workers is determining whether the business meets the requirements of section 530. If so, the business will not have an employment tax liability with respect to the workers at issue. As a result, IRS examiners will now consider the taxpayer's eligibility for relief under section 530 of the Revenue Act of 1978 before initiating any examination of the relationship between a business and a worker.

The application of section 530 of the Revenue Act of 1978 is considered an appropriate issue for early referral under section 2.02 of Announcement 96-13. Taxpayers that disagree with the District's determination regarding the application of section 530 of the Revenue Act of 1978 have the option of immediately requesting early referral of the issue from the District to Appeals. Appeals will try to resolve the section 530 issue following the procedures set forth in Announcement 96-13 and Revenue Procedure 96-9, 1996-1 C.B. 575. See section 6 of Announcement 96-13. If the section 530 issue remains unresolved, or if it is determined that the taxpayer is not eligible for relief under section 530, the case will be returned to the District for consideration of the worker classification issue(s).

A one-year test of the employment tax early referral procedure concluded on March 18, 1997. During the additional one-year test period, Appeals will try employment tax early referral in more cases so that the program can be further evaluated.

**Effective Date:** This Announcement extends the test of the employment tax early referral procedure set forth in Announcement 96-13 for an additional one-year period beginning May 27, 1997.

**For further information contact:** Thomas Carter Louthan, Director, Office of Dispute Resolution and Specialty Programs,

National Office Appeals, (202) 401-4098 (not a toll-free number).

### Foundations Status of Certain Organizations

#### Announcement 97-53

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

**Former Public Charities.** The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

African American Business Council of Niagara County Inc., Niagara Falls, NY

Alameda High School Alumni Association, Inc., Alameda, CA

Alaska Firebirds, Inc., Anchorage, AK

Alaska Youth Ready for Work, Inc., Anchorage, AK

Alta District Hospital Foundation Incorporated, Dinuba, CA

Alliance of the Holy Family Inc., Hillsborough, CA

American Association of Vietnam Veterans, Inc., Santa Rosa, CA

American College of Productivity & Enterprise, San Francisco, CA

Barron Area Educational Foundation Inc., Barron, WI

Bethel Alumni Association of North America, Inc., Monterey Park, CA

Beyond Survival, Irvine, CA

B. King Productions Inc., New York, NY

Black Knights Drum Corps, Burbank, CA

Blossom Valley Pony Baseball, San Jose, CA

Blue Ridge Resource Conservation and Development Council, Jefferson, NC

Cumberland Communities

Communications Corporation, Duff, TN

Cumberland County Scholarship Fund, Inc., Burkesville, KY  
 Cypress Creek Community Chorale Inc., Spring, TX  
 Dominic J. Bruno Education Trust, West Roxbury, MA  
 Doulos Ministry Inc., La Mirada, CA  
 Eastern Carolina Orchestra and Chamber Music Association, Greenville, NC  
 East Texas Hope Center, Longview, TX  
 Fire District No. 7 Services, Newport, WA  
 Flora Foundation, Kailua Kona, HI  
 Florence Housing Development Authority, Florence, AL  
 Foothills Audubon Club, Longmont, CO  
 For Children Only, Denver, CO  
 Forest Lake Wavemakers, Inc., Forest Lake, MN  
 Fort Collins Wildlife Coalition, Fort Collins, CO  
 Fort Dix Academy Inc., Morristown, NJ  
 Genesis-A-Sanctuary for the Arts, San Jose, CA  
 George Snively Research Foundation, Odessa, TX  
 Hedges and Highways, Compton, CA  
 Help Resources Group, El Paso, TX  
 Help Services, Kirkland, WA  
 Heritage Theatre Group, Grand Rapids, MI  
 High Desert Aids Outreach, Victorville, CA  
 Highland Park Non Profit Housing Corp., Highland Park, MI  
 Hillcrest Group Home Inc., Trenton, NJ  
 Holland Turner Foster Family Home, Round Rock, TX  
 Inner City Action Ministries, Inc., Grand Island, NY  
 Institute for Environmental Systems and Technologies, Reseda, CA  
 Institute for Transportation and the Environment, Seattle, WA  
 Institute of Chinese Medicine for Immunodeficiency Disorders, Long Beach, CA  
 Institute of Communication for Understanding, Berkeley, CA  
 Jesus Never Fails Pentacostal Church, Chicago, IL  
 Jochua House Home for Boys, San Bernardino, CA  
 John Hazelton Day Center Inc., Viroqua, WI  
 J-Spar Foundation, Oceanside, CA  
 Jumelage, Inc., Winchester, MA  
 Kanesville, Inc., Council Bluffs, IA  
 Ka Ohana Punana Leo O. Kaua I, Inc., Puhi, HI  
 Leap Imagination in Learning, San Francisco, CA  
 Lees Transitional Housing & Emergency Shelter, Los Angeles, CA  
 Leo D. Lagasse Society, Los Angeles, CA  
 Leonard Mendoza Jr. Foundation Inc., Commerce, CA  
 Lewis Residential Care Inc., Stockton, CA  
 Life Saviors Rescue and Recovery Exchange, Mira Loma, CA  
 Light Evangelical Mission, Bellflower, CA  
 Linda Vista Multi-Cultural Fair Inc., San Diego, CA  
 Mayors Committee for a Better Community, Las Vegas, NV  
 Medical Supplies for Zambia Inc., Wildomar, CA  
 Medjugorje Connection Inc., Boise, ID  
 Metropolitan Education Foundation, New Orleans, LA  
 Mexican American Bar Foundation, Los Angeles, CA  
 New Life International Missions to India and to the World Inc., Long Beach, CA  
 New Voice Club of the Valleys, Studio City, CA  
 New York State Tenents & Neighborhood Coalition Rochester Chapter, Rochester, NY  
 Nipomo Football League, Nipomo, CA  
 Nonprofit Community Network, Seattle, WA  
 Pikes Peak Childrens Advocates Inc., Colorado Springs, CO  
 Pillar Incorporated, Abita Springs, LA  
 Plant Closures Project, San Francisco, CA  
 Polemical Success International, Inc., Boca Raton, FL  
 Pomona Mission Transitional Shelter, Chino, CA  
 Rapid City Teen Center, Rapid City, SD  
 Robert E. Lee Project, Sacramento, CA  
 Robert Ford Memorial Scholarship Fund, Freeport, NY  
 Roberts Family Foundation, Bainbridge Island, WA  
 Rocky Mountain CFS Association, Inc., Aurora, CO  
 SAARC Foundation USA, New York, NY  
 SCIO District 95 C Scholarships, Inc., Scio, OR  
 Seneca Hill Manor Inc., Oswego, NY  
 Shakan Group Homes, South Bend, IN  
 Share Christmas, Elyria, OH  
 SHDC No. 2 Inc., Honolulu, HI  
 Sherman Group Home Inc., Bakersfield, CA  
 Silver Cane Foundation, Santa Barbara, CA  
 Silver Foxes Theatrical Troupe, Streamwood, IL  
 Siskiyou Child Abuse Prevention Council, Yreka, CA  
 Temple Community & Economic Development Corporation, Philadelphia, PA  
 Tiger Aquatics Boosters Club, Stockton, CA  
 Topdog Wrestling Club, Inc., Sandpoint, ID  
 United Bicolandia Los Angeles, Los Angeles, CA  
 Valley Air Trust Incorporated, Jamestown, CA  
 Valley Oak Soccer Club—VOSC, Fresno, CA  
 Valley Voice Youth Choir, Kent, WA  
 Veterans Helping Veterans, Los Angeles, CA  
 Vietnam and the World Foundation Inc., Huntingdon Beach, CA  
 Vietnam Community, Amarillo, TX  
 Vietnam Museum in Hawaii, Honolulu, HI  
 Vietnam Veterans United for Aid and Assistance, San Jose, CA  
 Who is My Neighbor Foundation, Valencia, CA  
 Widowed Persons Service of Inland Valley Inc., Oceanside, CA  
 Wildcat Booster Club, Vacaville, CA  
 Wilikina Park, Honolulu, HI  
 William Roberts Memorial Social Services Foundation, Inc., Chicago, IL  
 Willow Area Seniors Incorporated, Willow, AK  
 Windmill Media Productions, Los Angeles, CA  
 Wings Club Scholarship Fund, Inc., New York, NY

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

## Definition of Terms

*Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:*

*Amplified* describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

*Clarified* is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

*Distinguished* describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling

is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

*Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

*Revoked* describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does

more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

*Supplemented* is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

*Suspended* is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

## Abbreviations

*The following abbreviations in current use and formerly used will appear in material published in the Bulletin.*

A—Individual.

Acq.—Acquiescence.

B—Individual.

BE—Beneficiary.

BK—Bank.

B.T.A.—Board of Tax Appeals.

C.—Individual.

C.B.—Cumulative Bulletin.

CFR—Code of Federal Regulations.

CI—City.

COOP—Cooperative.

Ct.D.—Court Decision.

CY—County.

D—Decedent.

DC—Dummy Corporation.

DE—Donee.

Del. Order—Delegation Order.

DISC—Domestic International Sales Corporation.

DR—Donor.

E—Estate.

EE—Employee.

E.O.—Executive Order.

ER—Employer.

ERISA—Employee Retirement Income Security Act.

EX—Executor.

F—Fiduciary.

FC—Foreign Country.

FICA—Federal Insurance Contribution Act.

FISC—Foreign International Sales Company.

FPH—Foreign Personal Holding Company.

F.R.—Federal Register.

FUTA—Federal Unemployment Tax Act.

FX—Foreign Corporation.

G.C.M.—Chief Counsel's Memorandum.

GE—Grantee.

GP—General Partner.

GR—Grantor.

IC—Insurance Company.

I.R.B.—Internal Revenue Bulletin.

LE—Lessee.

LP—Limited Partner.

LR—Lessor.

M—Minor.

Nonacq.—Nonacquiescence.

O—Organization.

P—Parent Corporation.

PHC—Personal Holding Company.

PO—Possession of the U.S.

PR—Partner.

PRS—Partnership.

PTE—Prohibited Transaction Exemption.

Pub. L.—Public Law.

REIT—Real Estate Investment Trust.

Rev. Proc.—Revenue Procedure.

Rev. Rul.—Revenue Ruling.

S—Subsidiary.

S.P.R.—Statements of Procedural Rules.

Stat.—Statutes at Large.

T—Target Corporation.

T.C.—Tax Court.

T.D.—Treasury Decision.

TFE—Transferee.

TFR—Transferor.

T.I.R.—Technical Information Release.

TP—Taxpayer.

TR—Trust.

TT—Trustee.

U.S.C.—United States Code.

X—Corporation.

Y—Corporation.

Z—Corporation.



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<sup>1</sup>A cumulative list of all Revenue Rulings, Revenue Procedures, Treasury Decisions, etc., published in Internal Revenue Bulletins 1996–27 through 1996–53 will be found in Internal Revenue Bulletin 1997–1, dated January 6, 1997.

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